In the Supreme Court of the United States

OCTOBER TERM, 1964

No. 75

COLORADO INTERSTATE GAS COMPANY, APPELLANT

v.

THE STATE CORPORATION COMMISSION OF THE STATE OF KANSAS, SOUTHWEST KANSAS ROYALTY OWNERS ASSOCIATION AND PANHANDLE EASTERN PIPE LINE COMPANY

No. 83

NORTHERN NATURAL GAS COMPANY AND CITIES SERVICE GAS COMPANY, APPELLANT

v.

THE STATE CORPORATION COMMISSION OF THE STATE OF KANSAS, SOUTHWEST KANSAS ROYALTY OWNERS ASSOCIATION AND PANHANDLE EASTERN PIPE LINE COMPANY

No. 140

KANSAS-NEBRASKA NATURAL GAS COMPANY, INC., APPELLANT

v.

THE STATE CORPORATION COMMISSION OF THE STATE OF KANSAS, SOUTHWEST KANSAS ROYALTY OWNERS ASSOCIATION AND PANHANDLE EASTERN PIPE LINE COMPANY

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF KANSAS

MEMORANDUM FOR THE FEDERAL POWER COMMISSION AS AMICUS CURIAE

This memorandum on behalf of the Federal Power Commission, as *amicus curiae*, supports the position

of appellees that these cases do not present a substantial federal question.[1]

Appellants challenge the validity of a series of orders of the Kansas Corporation Commission determining the "allowables", or maximum production quotas, for wells in the Kansas portion of the Hugoton Gas Field. The method of determining allowables employed in these orders differs in certain respects from the method traditionally used by the Kansas Commission prior to May, 1956. It is in fact less restrictive of production. The appellants nonetheless contend that the challenged orders encroach upon the jurisdiction of the Power Commission under the Natural Gas Act. However, inasmuch as the instant orders, unlike the ratable-take orders condemned by this Court in *Northern Natural Gas Co.* v. *State Corporation Commission of Kansas*, 372 U.S. 84, are directed at producers rather than pipelines, and regulate production rather than purchasing, the Power Commission believes that they fall within the sphere of natural gas regulation reserved to the States by Section 1(b) of the Natural Gas Act, 15 U.S.C. 717(b). To be sure, an indirect effect of the orders may be to increase the overall pipeline purchases in the Kansas and Hugoton Field. But the orders themselves do not require any such increase or indeed any modification whatever in established purchasing patterns.

[1] We express no opinion on the alternative ground of appellees' motions that the appeals should be dismissed because the State Court's orders rest on adequate non-federal grounds.

Pursuant to its Basic Proration Order for the Hugoton Gas Field (Jur. Statement in No. 83, pp. A 161–A 181), promulgated in 1944 and not in dispute here, the Kansas Commission issues a semi-annual order determining the market demand for natural gas for each of the ensuing six months. The current monthly allowable for the field is determined on the basis of the market demand figure for that month and is spread ratably among all the wells in the field. Each well is required to carry forward its underages (allowables in excess of production) or overages (production in excess of allowables) from prior periods; in any given month the "net allowable" for a well—the volume it is authorized to produce—is the current allowable (the pro rata share of the current field allowable) plus the accumulated underages or minus the accumulated overages of previous periods. When the accumulated underages exceed a certain level (six times the current allowable assigned to the well for the preceding January), the excess is cancelled and redistributed among all the wells in the field; when the accumulated overages exceed that level, the well is temporarily shut in (Jur. Statement in No. 83, A 176–A 177).

Prior to May, 1956 it was the Kansas Commission's practice to base its semi-annual determination of market demand solely upon estimates, or "nominations", by the pipeline companies of the amount they expected to purchase from the field in the following six months. The current monthly allowable was de-

rived from the monthly market demand figure (a) by adding to the latter the amount of any underages cancelled during the preceding month, and (b) by adding to that total the net overage, or subtracting the net underage, recorded by all wells during the preceding month. The figure thus derived was then spread ratably among the wells.

The practical effect of this method was described by the court below as follows (Jur. Statement in No. 83, pp. A 11–A 12):

> This method of calculating the allowables not only tended to hold the allowables to the requirements of the pipeline companies taking the least amount of gas from the field in proportion to which its connected reserves bore to the field as a whole, but prevented increased takes of gas by one company when it acquired new consumer markets unless the other pipelines also wanted to take more gas. If one pipeline company nominated to receive more gas, the extra allowable would be spread among all the wells in the field. If the other pipeline companies continued taking at the old rate, an underage would be created. The following month this underage would be deducted from the market demand to find the current allowable so they would be back where they started. Obviously one pipeline company could not effect any material change in the allowables unless the other pipeline companies went along with it. The pipeline companies did not expand at the same time, when one wanted more gas, the rest could exercise veto power.

These consequences may be illustrated by supposing that three producers, A, B, and C are entitled to equal shares of the gas in a common reservoir. Initially A nominates 30 units and B and C nominate 15 each for the next month. The current allowable for the field would be 60 and each producer would have an allowable of 20. If A produces his full allowable of 20 and B and C their nominations of 15, B's and C's underproduction of 10 (5 each) would be subtracted from the succeeding month's nominations. If these remained unchanged, the new current allowable for the field would be only 50 and the allowable for each purchaser would be reduced to 16⅔. Thus, even if A still has a potential market of 30, his allowable decreases so long as B and C take less than their allowables. Appellants do not question the validity of that method; on the contrary, they urge its reinstatement.

In May 1956, the Kansas Commission began to experiment with its method of determining allowables. The method finally adopted, and reflected in the order here in issue, differs from that used from 1944 to 1956 in two respects. First, the Commission's determination of the market demand for the ensuing six months no longer depends exclusively on the market estimates of the pipeline companies; the Commission also considers evidence of how much the pipelines are purchasing from other sources of supply, the gas sales of all pipelines purchasing from the Kansas-Hugoton Field, and the rate of increase of those sales compared to the rate of increase in withdrawals from

the Kansas portion of the Hugoton Field. More significantly, the overages or underages of the preceding period are no longer added to or subtracted from the market demand figure in computing the current allowable, which, under the present method, is the sum of market demand and cancelled underages.

This method permits pipeline companies, if they choose, to purchase more gas from the Kansas Hugoton field; that is to say, low runs of other companies no longer entail an automatic contraction of the current field allowable. In addition, the change in determining allowables has resulted in a large accumulation of underages, many of which have been cancelled. In December 1963, however, the Kansas Commission entered an order providing that no underages would be cancelled in 1964 and that underages previously cancelled would be reinstated upon application showing that the wells are capable of producing the amounts in question and that the purchaser will take such amounts, provided that the amounts so restored are run within the twelve-month period following reinstatement. (See Jur. Statement in No. 83, p. 30, n. 33.)

2. Appellants claim that the Kansas Commission orders applying the new method of determining market demand and current allowables invade the province of the Federal Power Commission under the Natural Gas Act. They maintain that the orders exert leverage upon them to alter their purchasing patterns so as to take more Kansas Hugoton gas.

Some pipelines, they reason, will be inclined to step up their rate of purchases, thereby "forcing" the appellants to increase their own takes in order to prevent the drainage of reserves by the other purchasers. Moreover, appellants fear that unless their purchases keep pace with the increase in allowables, their accumulated underages will reach the level at which they are subject to cancellation by the Commission, with resultant loss of potential future production. Neither of these objections, in our view, presents a substantial federal question.

(a) The State of Kansas plainly has no duty under federal law to regulate the production of natural gas *at all*, much less to limit production to any particular level (*e.g.*, the level of pipeline nominations). Yet that, in essence, is what the appellants' "drainage" argument comes to. The nub of their complaint is not that the orders in question are unduly restrictive, but that they are not restrictive enough; *i.e.*, they do not sufficiently inhibit other pipelines from taking gas at a rate which threatens to drain the appellants' reserves. Such a protest, we submit, is properly addressed to the Kansas Commission or to the State legislature, but it raises no constitutional issue either under the Supremacy Clause or under the Fourteenth Amendment.

It should be emphasized that the risk of drainage does not result from any affirmative action on the part of the State. It would be more extreme if there were no State controls. Whenever a number of pro-

ducers are withdrawing gas from a common reservoir at unequal rates of production, there is the prospect, rooted in the law of physics, that reserves may migrate from areas of low production to areas of higher output where the level of pressure is apt to be lower. State regulation may in varying degrees tolerate this condition, but in no sense is the condition created or aggravated by the State. Even under the Kansas Commission's traditional method of fixing allowables, which the appellants do not challenge, there was a substantial possibility that wells whose production level was below the field average would incur drainage. Indeed, the only system of regulation calculated to eliminate that possibility altogether would be one which either imposed a uniform rate of production upon all wells in the field or which prescribed as a ceiling for all wells the lowest rate of production achieved by any of them. Appellants do not urge that such drastic regulation is constitutionally mandatory, but neither do they suggest any criteria for determining at what point the amount of probable drainage tolerated by the Commission's orders becomes, for constitutional purposes, excessive.

It may well be that the Commission's new, and more liberal, method of determining allowables would permit a somewhat greater measure of drainage and to that extent make it advantageous for the appellants to increase their purchases in Kansas. But, by the same token, even greater leverage would be exerted

by an order which lifted production controls entirely. The logic of the appellants' argument would thus lead to the extraordinary conclusion that the less restrictive the State's regulation of production becomes, the more it impinges upon the jurisdiction of the Power Commission, and that a State statute which did away with the proration system altogether would represent the maximum encroachment upon the federal domain.

It should be pointed out, finally, that while the orders here challenged may tolerate more drainage within the Kansas portion of the Hugoton Field, one of their declared purposes was to reduce the migration of reserves from the Kansas portion to the Oklahoma portion of the field. Those producers and purchasers (*e.g.*, the appellee Panhandle) whose operations were curtailed by the Commission's former method of determining allowables, and whose reserves were thereby subjected to drainage by Oklahoma wells producing at a higher rate, could make the same objection to the former method that the appellants make to the present method. And whereas the drainage now complained of is not the result of any affirmative action by the Kansas Commission, the migration of Kansas reserves to Oklahoma was attributable, in part at least, to the restrictions imposed by the Kansas Commission. That Commission was not obliged to give greater weight to the interests of the appellants than to those of the appellees.

(b) The appellants' other contention, *i.e.*, that the orders will cause them to lose reserves through the cancellation of underages—is also insubstantial. We note first that the appellants do not question the power of the Kansas Commission to cancel underages; they have challenged neither the Basic Proration Order of 1944, which established the procedure for cancellation, nor any specific cancellation order. Moreover, there seems little basis for arguing that a State commission, in fixing the current production quota for a well, is obligated to make an adjustment for prior underages, *i.e.*, to permit the underproduction of the past to be "made up" by future production in excess of allowables. *A fortiori*, it may place a maximum limit upon the amount of underages which it permits to be carried forward, as the Kansas Commission has done.

The appellants' argument appears to be not that the Commission must refrain from cancelling underages, but that it must determine allowables in such a way that there are no underages to be cancelled. Again, however, the appellants do not insist that the Commission adopt a form of regulation which would rule out underages altogether (*e.g.*, one which limited all wells to the production rate of the least productive well). The State's traditional method of fixing allowables, with which the appellants appear to be content, permitted the accumulation of substantial underages. Yet petitioners offer no explanation as

to why that method was permissible, while the method which replaced it is not.

In any event, even if the "cancellation" issue were otherwise substantial, there would be no occasion for the Court to entertain it at this time. As noted, the Kansas Commission has declared a moratorium upon the further cancellation of underages and has announced that any underages previously canceled will be reinstated under certain conditions (*supra*, p. 6). As yet, therefore, none of the appellants has irrevocably lost any of its underages. Moreover, cancellation does not injure a producer or pipeline unless and until it is in a position to make use of the underages. Only when a pipeline is willing and able to take gas in excess of its current allowables, and has been barred from doing so, can it reasonably claim to have sustained injury by virtue of the cancellation of its underages. There is no assurance that any of the appellants will ever be in that position, or, if they are, that the Kansas Commission, in the exercise of its discretion, will not reinstate cancelled underages as it has in the past. In these circumstances, the argument based upon the threat of cancellation is speculative.

3. Appellants' reliance upon *Northern Natural Gas Co.* v. *State Corporation Commission* is misplaced. That case involved the validity of the Kansas Commission's "ratable-take" orders, which required the pipeline to take from each well the same proportion of that well's allowables as it took from every other

well in the same field. This Court held the order invalid chiefly on the ground that it was directed at the purchasing pipeline, rather than the producers of the gas. 372 U.S. at 90, 92. In addition, the Court stressed the fact that the ratable-take order would have required a readjustment of the purchasing pattern of any pipeline taking unratably and thus could interfere with the Power Commission's functions and affect consumer prices. 372 U.S. at 94.

By contrast, the presently challenged orders setting the production quotas for each well, are addressed solely to the producers, not the pipelines. Moreover, while the ratable-take orders in *Northern required* the pipeline to shift its purchasing patterns and imposed criminal penalties for non-compliance (372 U.S. at 92), the present orders merely *permit* a change in purchasing patterns; they impose no requirement of law. Thus neither of the factors which invalidated the ratable take order in *Northern* is present here.[2]

To be sure, any method of prorationing will have some economic effect upon the operations and pur-

[2] Colorado Interstate (Jurisdictional Statement, p. 24) mistakenly relies on the Federal Power Commission's memorandum in support of the jurisdictional statement in *Northern*. In that memorandum, after outlining the very orders involved here (which had not then been judicially reviewed), the Commission (p. 8) recognized the difference between the permissive allowable orders and the mandatory ratable take orders, stating that the "ratable-take order here involved supplied the element that was missing in the Kansas Commission's previous attempts to force more Kansas gas into the interstate market by merely raising the allowables, or ceilings."

chasing patterns of interstate pipelines. Appellants' approach—that they can show some leverage upon their purchasing practices—would pave the way for the invalidation of all State prorationing and similiar conservation orders, a result clearly inconsistent with the "production and gathering exemption" of the Natural Gas Act and this Court's recognition in the *Northern Natural* case, 372 U.S. at 93–94, that the States' power to conserve and allocate natural gas was not wholly preempted by the Gas Act.

4. Colorado Interstate, alone among the appellant pipelines, has contracts requiring it either to take or to pay for all allowables set by the Kansas Commission. Seeking to lift itself by its bootstraps, it urges (Jurisdictional Statement, p. 24) that the Kansas orders are invalid because they make it "probable that it may have to pay for gas which it does not currently purchase and may never be able to purchase." Any method of prorationing, however, would subject a purchaser to the risk that it might not be in a position to take all of the allowables available to it and that, under a contractual undertaking to do so, it might be required to pay for gas not taken. The mere fact that a pipeline has bound itself by contract to purchase the maximum amount of gas permitted by State regulation does not convert a permissive proration order into a mandatory one. Nor can such a contract provision exempt the pipeline from otherwise valid State regulation. Thus, if, as we believe, the Kansas

orders do not otherwise impinge upon the regulatory function of the Power Commission, the existence of the take-or-pay provisions does not alter the result.[3]

For the foregoing reasons, it is the view of the Federal Power Commission that the Kansas orders here in issue do not invade the domain of federal regulation or give rise to a substantial federal question.

Respectfully submitted,

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[3] If the type of take-or-pay provisions Colorado Interstate has in its contract operates contrary to the public interest, the proper solution would appear to be for Colorado Interstate or its customers to seek to have the Power Commission exercise its authority under Section 5(a) of the Natural Gas Act, 15 U.S.C. 717d(a), to order the contracts reformed.

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